Pacific Gas and Electric Company

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January 17, 2007 **VIA EXPRESS MAIL AND EMAIL**

Department of Water Resources
California Energy Resources Scheduling Division
3310 El Camino Avenue, Suite 120
Sacramento, CA 95821-9001

ATTENTION: Ms. Iryna Kwasny

Re: December 27, 2008 DWR Proposed Supplemental Determination of 2008 Revenue Requirements

Pursuant to California Code of Regulations Section 515 and the California Administrative Procedure Act, Pacific Gas and Electric Company ("PG&E") hereby provides the following comments on the December 27, 2007, submission by the Department of Water Resources (DWR), entitled "Proposed Supplemental Determination of Revenue Requirements For the Period January 1, 2008 Through December 31, 2008" ("Proposed Supplemental Determination"). PG&E appreciates the opportunity to comment on the Proposed Supplemental Determination.

The sole significant reason for the Proposed Supplemental Determination appears to be DWR's December 7, 2007, decision to terminate its long-term, 1000 MW contract with Calpine Energy Services, L.P. ("Calpine 2 contract") and replace the contract with a 180 MW unit-contingent dispatchable contract for 2008 and 2009, with an option to extend through 2012. (Proposed Supplemental Determination, p. 14.) According to DWR, the Calpine 2 long-term contract "has been replaced" by the 180 MW unit-contingent contract. (*Id.*)–DWR states that it will make its "just and reasonable" determination after review of comments from interested parties. (Proposed Supplemental Determination, p. 31.) Nonetheless, on December 14, 2007, DWR wrote the California Public Utilities Commission (CPUC), stating that termination and replacement of the Calpine 2 contract "provides net savings to statewide ratepayers." (Letter from Lester Snow, Director, DWR, to Michael Peevey, President, CPUC, December 14, 2007.)[1/] Also, on

1/ The December 14, 2007, DWR letter to the CPUC asserts that the Calpine 2 "contract restructuring is consistent with the State's objective of reducing its overall power supply obligations on behalf of the retail customers of the three IOUs,…." This objective is not within the statutory criteria applicable to DWR's power contracting activities under the Water Code. See Water Code Section 80100(a)("The intent of the

December 21, 2007, the Chair of the California Assembly Committee on Utilities and Commerce wrote DWR, requesting that DWR provide various documents, analyses and information regarding the impact of the Calpine 2 termination on electricity costs, supplies and reliability in the State. (Letter from Lloyd Levine, Chair, Assembly Committee on Utilities and Commerce, to Lester Snow, Director, DWR, December 21, 2007.)

Information on net savings, including detailed assumptions and analysis, are important for the public and other interested parties to assess the net ratepayer costs and benefits of DWR's termination and replacement of the Calpine 2 contract. PG&E understands that DWR will be providing its detailed analysis of those net ratepayer costs and benefits in the near future, so that the public and other interested parties and policymakers can comment on whether the Proposed Supplemental Determination is "just and reasonable" as required by law. PG&E notes that DWR has committed that if it relies on any additional, significant material not identified in the Proposed Supplemental Determination, it will provide the public with an opportunity to comment on the additional material[2/], and PG&E reserves its rights to provide additional comments.

PG&E reiterates its request that DWR provide its detailed analysis—including inputs, market data, sources of assumptions, and analytical basis—of the customer impacts of the Calpine 2 termination include the following issues:

- Amount of replacement power and costs that PG&E's customers will incur to replace the energy lost by the Calpine 2 termination.

- A reconciliation of the difference in replacement power needed by PG&E between DWR's Calpine 2 restructuring analysis and its "residual net short" determination in its Proposed Supplemental Determination. PG&E notes that DWR's Proposed Supplemental Determination estimates that PG&E's "residual net short," i.e. the amount of power PG&E will need to procure to replace the lost Calpine 2 energy, will be approximately the full 100% of energy formerly supplied by Calpine 2.[3/]

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program...is to achieve an overall portfolio of contracts for energy resulting in reliable service at the lowest possible price per kilowatthour.")

2/ "Notice of Proposed Supplemental Determination of 2008 Revenue Requirements," DWR, December 27, 2007, p. 2.

3/ The difference between DWR's forecast "residual net short" for PG&E and the other IOUs in its October 31, 2007, "Revision to the Determination of Revenue Requirements for 2008," which included Calpine 2 energy, and its December 27, 2007, "Proposed Supplemental Determination of Revenue Requirements for 2008," which included the effects of terminating Calpine 2, is 8,493 GWH—100% attributable to the energy forecast to be supplied by Calpine 2 to PG&E's customers before the contract was terminated. (See Table D-3, "Residual Net Short (Surplus)", October 31, 2007 "Revision to the Determination of Revenue Requirements for 2008, p. 14; Table D-3, "Residual Net Short (Surplus)", December 27, 2007 Proposed Supplemental Determination of Revenue Requirements for 2008, p. 12. The following calculation

- The impacts on PG&E customers of the overall reduced adequacy of resources due to termination of the Calpine 2 1000 MW, around-the-clock power and replacement with only 180 MW of "peaking" capacity, particularly during the potential drought conditions in Northern California and the Northwest that may prevail during 2008 and 2009. Current market and forecast prices for replacing the value of this 820 MW of lost "resource adequacy" in 2008 and 2009 should be used.

- An explanation of why a replacement product priced much higher than the original Calpine 2 energy with a very low expected capacity factor was selected to replace the Calpine 2 contract. An analysis that demonstrates how the 180 MW replacement product fits or does not fit into the PG&E portfolio is also requested.

- The value of the 180 MW of new peaking capacity that is being provided under the new DWR contract entered into with Calpine to replace the Calpine 2 contract.

DWR also should address whether it has the legal authority to terminate the Calpine 2 contract and replace it with the new, 180 MW peaker contract as proposed, in light of the prohibition in Water Code Section 80260.[4/]

On a technical note, PG&E would like a better understanding of how DWR determined the amount of energy DWR forecasts from the PacifiCorp contract.

Finally, based on discussions with DWR personnel, PG&E believes DWR should correct the implication in its proposed determination that an additional $93 million decrease in reserves (and the revenue requirement) is related to the Calpine termination. In fact, PG&E understands that

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demonstrates how the 8,493 GWH change in residula net short ties directly to the 8,784 GWH that would have been supplied in a leap year from the terminated Calpine 2 contract:

Gross Calpine 2 Delivers	8,784 GWH
Generator-to- CAISO Loss Factor	1.0236
Net Calpine 2 Deliveries	8,582 GWH
Generation from Peaking Contract	1 GWH
Forecast Increase in IOU Generation and Decrese in Exports	88 GWH
Increase in Residual Net Short Position	8,493 GWH

4/ PG&E notes that in 2004, DWR sought but did not receive additional statutory authority to renegotiate its power contracts. In considering DWR's request, the State Assembly Utilities and Commerce Committee analysis of AB 2767 stated that "The sponsors believe, and the Attorney General has opined, that DWR's authority to administer long-term energy contracts includes certain rights to renegotiate those contracts. However, the sponsor points out that *this authority is not explicit* and the absence of explicit authority has hampered some re-negotiation efforts. *Furthermore, the Attorney General has issued an opinion on this matter that it only applies on a case-by-case basis….*" (emphasis added.) ("AB 2767 Bill Analysis," Assembly Committee on Utilities and Commerce, May 3, 2004.)

the $93 million decrease is attributable to a completely unrelated decision to no longer maintain reserves to defray a forecast remittance rate increase in 2010. In this regard, DWR should also address whether additional reductions in reserves may be warranted in light of DWR's overall revenue requirement and power contracting program.

We appreciate your consideration of these comments.

Very truly yours,

Christopher J. Warner

CJW:mw

Cc: Lester A. Snow, Director, California Department of Water Resources
Timothy J. Haines, CERS
Michael R. Peevey, President, California Public Utilities Commission
Hon. Lloyd E. Levine, Chair, Assembly Committee on Utilities and Commerce